

Message Text

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ACTION AF-10

INFO OCT-01 ISO-00 EB-08 COME-00 TRSE-00 OMB-01 AID-05

INT-05 OES-07 CIAE-00 INR-10 NSAE-00 DODE-00 /047 W

-----029572 061016Z /21

R 051902Z JUL 78

FM AMEMBASSY LUSAKA

TO SECSTATE WASHDC 8791

C O N F I D E N T I A L SECTION 1 OF 2 LUSAKA 2382

E.O. 11652: GDS

TAGS: EMIN EFIN

SUBJ: GRZ SUGGESTS MINING COMPANIES DEBT BE USED FOR NEW
CAPITALIZATION

SUMMARY

AMAX ZAMBIA LTD. HAS INFORMED EMBASSY THAT GRZ HAS PROPOSED TURNING DEBT OWED BY ROAN CONSOLIDATED MINES (AMAX IS MINORITY SHAREHOLDER IN ROAN) TO MINISTRY OF FINANCE INTO NEW CAPITALIZATION. IN EFFECT, GRZ WOULD BE INCREASING ITS PERCENTAGE OWNERSHIP OF AMAX AND DILUTING THE HOLDINGS OF THE OTHER SHAREHOLDERS. INITIAL GRZ PROPOSAL IS TO CONVERT TO SHARES AT PAR VALUE WHICH AMAX CONSIDERS UNFAIR. ANGLO AMERICAN CORP., MINORITY SHAREHOLDER IN ROAN AND NCHANGA CONSOLIDATED MINES IS FACED WITH SIMILAR SITUATION BUT HAS NOT APPROACHED EMBASSY. END SUMMARY.

1. AMAX ZAMBIA LTD., A SUBSIDIARY OF AMAX INC. OF GREENWICH, CONNECTICUT AND MINORITY SHAREHOLDER IN ROAN CONSOLIDATED MINES (RCM), ONE OF ZAMBIA'S TWO MAJOR MINING COMPANIES, HAS BROUGHT TO EMBASSY'S ATTENTION A MATTER WHICH MAY SERIOUSLY AFFECT THE COMPANY'S POSITION IN ZAMBIA. A SIMILAR SITUATION MAY AFFECT ANGLO AMERICAN CORPORATION'S POSITION WITH RESPECT TO THEIR HOLDINGS IN BOTH RCM AND NCHANGA CONSOLIDATED MINES (NCCM). ANGLO AMERICAN HAS NOT, HOWEVER, RAISED THE MATTER WITH THE
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EMBASSY.

2. AS BACKGROUND, THE GRZ MAINTAINS A 51 PERCENT SHARE OF BOTH RCM AND NCCM. THE REMAINING 49 PERCENT OF EACH COMPANY IS HELD BY VARIOUS OVERLAPPING COMPANIES AND INDIVIDUAL STOCKHOLDERS BUT EFFECTIVELY CONTROLLED BY AMAX AND ANGLO AMERICAN. ARTICLES OF INCORPORATION AND AGREEMENTS BETWEEN THE MAJORITY

AND MINORITY SHAREHOLDERS OFTEN GIVE ANGLO AMERICAN AND AMAX "BLOCKING" POWER DESPITE THEIR MINORITY POSITION.

3. BOTH RCM AND NCCM HAS BEEN OPERATING UNPROFITABLY AS A RESULT OF THE LOW WORLD COPPER PRICE AND INCREASING COSTS OF PRODUCTION IN ZAMBIA. IN ADDITION, MANAGEMENT OF THE MINES HAS BEEN LESS THAN EFFICIENT. POLITICAL CONSIDERATIONS HAVE TAKEN PRECEDENCE OVER ECONOMICS AND THE MOST NOTICEABLE RESULT HAS BEEN A DRAMATIC INCREASE IN THE LABOR FORCE AT THE MINES. THE INCREASED LABOR FORCE HAS NOT RESULTED IN A PROPORTIONATE PRODUCTION INCREASE, RATHER, PER CAPITA COPPER PRODUCTION HAS DECLINED. THUS, KWACHA COSTS OF OPERATING THE MINES HAVE INCREASED WHILE FOREIGN EXCHANGE RECEIPTS FROM SALES HAVE DECLINED. THE RECENT KWACHA DEVALUATION WAS AIMED SPECIFICALLY AT IMPROVING THE MINES' KWACHA LIQUIDITY POSITION (REDUCING LOSSES) WITHOUT LAYING OFF AS MANY WORKERS AS MIGHT OTHERWISE HAVE BEEN NECESSARY. (AN OBVIOUS POLITICAL CONSIDERATION IN THIS, AN ELECTION YEAR).

4. IN ORDER TO SUSTAIN COPPER PRODUCTION (A NECESSITY AS IT IS ZAMBIA'S ONLY FOREIGN EXCHANGE EARNER) BOTH RCM AND NCCM HAVE BEEN FORCED TO BORROW HEAVILY FROM THE BANK OF ZAMBIA. BY EARLY 1978, THE COMPANIES' INDEBTEDNESS TO THE BANK EXCEEDED \$100 MILLION FOR RCM AND \$60 MILLION FOR NCCM. (ROAN HAS MORE OF A PROBLEM IN THAT THEIR LUANSHYA MINE IS AN EXTREMELY UNECONOMIC OPERATION. NCCM'S LOSSES HAVE BEEN LESS PARTLY BE-
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CAUSE OF THE EFFICIENCY OF THEIR LEACH PLANT AT THE CHINGOLA DIVISION). THE LOANS BY THE BANK OF ZAMBIA WERE "SHORT TERM" AND CALLABLE AT ANYTIME.

5. THIS SHORT TERM INDEBTEDNESS WAS APPROACHING (AND IN RCM'S CASE MAY HAVE EXCEEDED) THAT PERMITTED BY THEIR ARTICLES OF INCORPORATION. IN ORDER TO "LEGALIZE" THEIR POSITION, RCM AND NCCM LOANS BY THE BANK OF ZAMBIA WERE ASSUMED BY THE MINISTRY OF FINANCE. THEY WERE CONVERTED TO INTEREST FREE LOANS AND DEEMED NOT CALLABLE FOR A YEAR. THIS PROCEDURE "LEGALIZED" THE POSSIBILITY OF SUITS AGAINST THE COMPANIES BY STOCKHOLDERS OR OTHERS.

6. THE MINISTRY OF FINANCE IS NOW OWED OVER \$160 MILLION BY THE TWO COMPANIES (IN WHICH THE GOVERNMENT IS MAJORITY SHAREHOLDER). NO ONE BELIEVES THAT RCM OR NCCM WILL EVER BE ABLE TO RETIRE THAT DEBT. ZAMBIA'S COSTS OF PRODUCTION WILL CONTINUE TO RISE AND, BARRING AN ASTRONOMICAL INCREASE IN COPPER PRICES, WILL NEED WHATEVER FUTURE REVENUES CAN BE REASONABLY EXPECTED TO SIMPLY MAINTAIN PRODUCTION, EXPLORATION, AND NEW DEVELOPMENT. IN SHORT, THE MINISTRY OF FINANCE WILL BE FOREVER LEFT HOLDING THE BAG. IT MUST BE KEPT IN MIND HOWEVER, THAT GRZ POLICY IN

EFFECT CREATED THAT "BAG".

7. COMES THE CRUNCH. THE GRZ NOW APPEARS TO HAVE DECIDED TO RECTIFY THE SITUATION. IT MAY BE THAT THEY SIMPLY BELIEVE THAT SOMETHING MUST BE DONE TO CLEAR THE BOOKS. IT MAY BE THAT THEY ARE INTERESTED IN "OWNING" MORE OF THE MINES. (THIS DOES NOT MAKE MUCH SINSE IN THAT THEY ARE LOSING MONEY). OR, AS MANY SUSPECT, IT MAY BE A FORM OF PRESSURE TO GET THE MINORITY SHAREHOLDERS TO INJECT NEW CAPITAL INTO THE MINES. FOR WHATEVER REASON, THE GRZ, THROUGH THE MINISTRIES OF MINES AND FINANCE HAVE PROPOSED CONVERTING THIS INDEBTEDNESS INTO NEW CAPITALIZATION.

8. BY SO DOING, ZAMBIA WOULD IN EFFECT INCREASE ITS PERCENTAGE
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SHAREHOLDINGS IN BOTH COMPANIES. THE AMOUNT OF THE INCREASE WOULD DEPEND ON AT WHAT VALUE NEW SHARES WERE CAPITALIZED, PAR, BOOK, OF FAIR MARKET VALUE. THE GRZ IN ITS INITIAL PROPOSAL HAS SUGGESTED CONVERSION AT PAR VALUE WHICH WOULD RESULT IN THE MOST DRAMATIC INCREASE IN HOLDINGS FOR THE GRZ AND, CONCURRENT-

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ACTION AF-10

INFO OCT-01 ISO-00 EB-08 COME-00 TRSE-00 OMB-01 AID-05
INT-05 OES-09 CIAE-00 INR-10 NSAE-00 DODE-00 /049 W
-----073746 101541Z /40/21

R 051902Z JUL 78
FM AMEMBASSY LUSAKA
TO SECSTATE WASHDC 8792

C O N F I D E N T I A L SECTION 2 OF 2 LUSAKA 2382

C O R R E C T E D C O P Y - T E X T (P A R A 1 4 .)

LY, THE MOST SIGNIFICANT REDUCTION IN THE PERCENTAGE SHARE OF MINORITY STOCKHOLDERS. CONVERSION AT BOOK VALUE WOULD HAVE LESS IMPACT. THE COMPANIES, AMAX AND ANGLO, WOULD PREFER THAT ANY CONVERSION BE AT MARKET VALUE. REGARDLESS OF THE CONVERSION

VALUE, AMAX AND ANGLO OBJECT TO THE GRZ PROPOSAL.

9. APART FROM THE PAPER LOSS IN PERCENTAGE SHAREHOLDINGS BOTH AMAX AND ANGLO WOULD INCUR, AMAX DOES NOT BELIEVE THE MOVE WOULD BE IN THE INTEREST OF THE COMPANY. THEY ARE CONCERNED THAT THE DECISION BY THE GRZ HAS BEEN HASTILY REACHED AND BELIEVE OUTSIDE FINANCIAL ADVISORS SHOULD BE BROUGHT IN TO ANALYSE THE SITUATION AND PROPOSE ALTERNATIVE SOLUTIONS. AS WELL, AMAX IS CONCERNED THAT THE DIRECTORS WILL BE OPENING THEMSELVES UP TO A SHAREHOLDERS SUIT IF THEY APPROVE CONVERSION TO CAPITAL AT SOMETHING LESS THAN FAIR MARKET VALUE. LASTLY AMAX POINTS OUT WITH SOME JUSTIFICATION, A MOVE OF THIS TYPE WILL REFLECT POORLY ON THE GRZ AND TARNISH ZAMBIA'S BUSINESS AND INVESTMENT IMAGE.

10. AS NOTED IN PARA 2 ABOVE, AMAX AND ANGLO BOTH APPEAR ABLE TO "BLOCK" THIS PROPOSAL OF ADDITIONAL CAPITALIZATION BUT ARE CONCERNED ABOUT BEING FORCED INTO THIS POSITION. THEIR DISCUSSIONS WITH THE GRZ ON THE MATTER ARE CONTINUING.

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11. ALTHOUGH NEITHER AMAX NOR ANGLO SPECIFICALLY REQUESTED EMBASSY ASSISTANCE IN THIS MATTER, EMBASSY ECON OFFICER HAD OPPORTUNITY FOR BRIEF DISCUSSION OF THE SITUATION WITH LLOYD SICHILONGO, NOW PERMANENT SECRETARY IN THE MINISTRY OF FINANCE. SICHILONGO WAS AN ALTERNATE MEMBER OF BOTH RCM AND NCCM BOARDS AND, IN HIS NEW POSITION, SHOULD BECOME A PERMANENT MEMBER.

12. SICHILONGO CONFIRMED THE BASICS OF PARAS 1 TO 10 ABOVE AND GAVE GRZ POSITION. HE SAID GRZ COULDN'T VERY WELL CARRY THIS DEBT FOREVER AND GAVE THE OPINION THAT THE BELIEVED GRZ SHOULD GET SOMETHING FOR THEIR MONEY. (THERE WAS NO DISCUSSION OF THE FACT THAT SOME, IF NOT MOST OF THE MINING COMPANIES' DIFFICULTIES, COULD BE BLAMED ON GRZ POLICY). SICHILONGO DENIED GRZ WAS ANXIOUS TO INCREASE ITS PERCENTAGE SHAREHOLDINGS IN THE COMPANIES AND SAID MATTER OF CONVERSION AT PAR, BOOK, OR OTHER VALUE WAS STILL A MATTER OF DISCUSSION. HE ADDED (AND HENCE THE SPECULATION THAT THE GRZ IS PRESSURING AMAX AND ANGLO) THAT THE GRZ WOULD LIKE TO MAINTAIN ITS 51 PERCENT SHAREHOLDINGS. THIS COULD BE ACHIEVED WITHING THE GRZ'S CONVERSION PROPOSAL BY HAVING THE MINORITY SHAREHOLDERS (AMAX AND ANGLO) INJECT NEW CAPITAL IN AN AMOUNT EQUAL TO THE DEBT CONVERTED BY THE GRZ. BY SO EOING, THE 51 PERCENT - 49 PERCENT SHAREHOLDING RATION WOULD BE MAINTAINED.

13. THE INJECTION OF NEW CAPITAL NOW BY EITHER AMAX OR ANGLO IN MONEY LOSING OPERATIONS IS VIRTUALLY IMPOSSIBLE. SUCH A DECISION BY THE MINORITY DIRECTORS WOULD HAVE TO BE CONSIDERED

IRRESPONSIBLE BY INDIVIDUAL SHAREHOLDERS AND ALMOST CERTAINLY
RESULT IN LEGAL ACTION AGAINST THE DIRECTORS. WHETHER THE GRZ
REALIZES THIS OR NOT IS NOT CLEAR. CERTAINLY AMAX AND ANGLO
WILL BE MAKING THE POINT IN DISCUSSION WITH THE GRZ.

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14. NEITHER

AMAX NOR ANGLO HAVE INDICATED TO THE EMBASSY THAT
A DECISION HAS BEEN REACHED. DISCUSSIONS WITH THE GRZ HAVE BEEN
INTERRUPTED BY THE ABSENCE OF KEY OFFICIALS ACCOMPANYING PRESIDENT
KAUNDA TO THE US AND ATTENDING THE IBRD-CHAired CONSULTATIVE
GROUP MEETINGS IN PARIS. PERSONNEL CHANGES, INCLUDING SICHILONGO
AND THE APPOINTMENT OF A NEW MINISTER OF MINES (JAMES MAPOMA)
WILL ALSO AFFECT THE PROGRESS OF THE DISCUSSIONS. FOR AMAX
AND ANGLO THE "BEST POSSIBLE SOLUTION" OTHER THAN THE GRZ
SIMPLY DROPPING THE PROPOSAL AND CARRYING THE DEBT, WOULD BE FOR
AN INDEPENDENT FINANCIAL ANALYSIS OF THE SITUATION WITH VARIOUS
ALTERNATIVE RECOMMENDATIONS. IDEALLY, AN ALTERNATIVE PROPOSAL
COULD BE THEN "SOLD" TO THE GRZ. FROM A FINANCIAL STANDPOINT
THE "BEST POSSIBLE SOLUTION" FOR THE GRZ WOULD BE SIMULTANEOUS
RECAPITALIZATION OF THE DEBT AND EQUAL INJECTION OF NEW CAPITAL
BY AMAX AND ANGLO, A SOLUTION THAT COULD NOT BE APPROVED BY
THE MINORITY SHAREHOLDERS. THUS, UNLESS THE GRZ WISHES TO
PRECIPITATE A CRISIS, THE INDEPENDENT FINANCIAL ANALYSES ROUTE
WOULD APPEAR TO BE A SUITABLE COMPROMISE. A COMPROMISE WHICH
COULD, OF COURSE, SIMPLY DELAY THE CRISIS SHOULD THE ALTERNATIVES
EVENTUALLY PROPOSED BE UNACCEPTABLE TO THE GRZ.

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 jan 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: MINING, DEBTS
Control Number: n/a
Copy: SINGLE
Draft Date: 05 jul 1978
Decaption Date: 01 jan 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 20 Mar 2014
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1978LUSAKA02382
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS
Errors: N/A
Expiration:
Film Number: D780277-0168
Format: TEL
From: LUSAKA
Handling Restrictions: n/a
Image Path:
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Legacy Key: link1978/newtext/t19780795/aaaadcfo.tel
Line Count: 257
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Litigation Codes:
Litigation History:
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Office: ACTION AF
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 5
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: n/a
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 28 apr 2005
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 2116418
Secure: OPEN
Status: NATIVE
Subject: GRZ SUGGESTS MINING COMPANIES DEBT BE USED FOR NEW CAPITALIZATION SUMMARY
TAGS: EMIN, EFIN
To: STATE
Type: TE
vdkgvwkey: odhc://SAS/SAS.dbo.SAS_Docs/7c0dfc7a-c288-dd11-92da-001cc4696bcc
Review Markings:
Sheryl P. Walter
Declassified/Released
US Department of State
EO Systematic Review
20 Mar 2014
Markings: Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014